

***IN THE MATTER OF:***

***Secure Energy v. Coal  
Synthetics***

***Cause No. 4:08-CV-01719-JCH***

***Deposition of G. William Kennedy  
10/23/2009***

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***Full GLOSSARY included with this DepoScript***

1 but generally can you tell me how many times you've  
2 testified about the valuation -- strike that.

3 How many times have you done analysis for  
4 litigation and provided testimony about the  
5 valuation of intellectual property?

6 A: I don't have a count off the top of my  
7 head.

8 Q: Let's try it this way. Of the  
9 approximately 50 percent over time -- the period of  
10 time that your work is devoted to litigation  
11 support, how much of that work is devoted to  
12 analysis and testimony of the valuation of  
13 intellectual property?

14 A: This would be just a rough, rough  
15 estimate. I'd say 10 percent, and I don't know that  
16 I've got a good basis for saying that. It's just an  
17 element of the various types of valuation matters  
18 that I've testified to in litigation.

19 Q: Would it be fair to say that you  
20 understand your work in this case to involve the  
21 valuation of intellectual property? Is that the  
22 concept?

23 A: Yes, sir.

24 Q: Do you have any other matters going on  
25 right now that you're involved in the valuation of

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1 intellectual property?

2 A: A matter going on right now that involves  
3 the valuation of intangible assets. Intellectual  
4 property is a category of intangible assets.

5 Q: What's the intangible asset in the other  
6 case?

7 A: Wide variety of typical intangible assets  
8 that a company might possess. Customer base, trade  
9 name, trademark, patents, the -- the broad sweep  
10 of --

11 Q: I would typically -- I didn't mean to  
12 interrupt you. Go ahead.

13 A: Just the broad sweep of what I could  
14 characterize as identifiable intangible assets.

15 Q: I would typically identify or categorize  
16 patents, trademarks, trade names as intellectual  
17 property. I take it you do not?

18 A: I'm not sure why you say that. No, I  
19 would characterize patents, trademarks, and --

20 Q: I think maybe we're not meeting here. I  
21 thought you were involved in something other than  
22 intellectual property; you were involved in some  
23 kind of intangible asset that wasn't intellectual  
24 property in that other matter.

25 A: I think what I said was the other matter  
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1 appear on pages -- the applications that appear on  
2 pages 7 and 8?

3 A: You asked me about -- and the underlying  
4 calculations for those.

5 Q: Oh, you mean the Secure Energy model?  
6 When you say the "model," what are you talking  
7 about?

8 A: My Excel spreadsheets.

9 Q: Your Excel spreadsheets. I didn't see  
10 those. They're not here, right?

11 A: I didn't print screen shots, no.

12 Q: What is that model? Tell me about that  
13 one.

14 A: What we did was replicate in Excel the  
15 financial forecasts that were presented by both  
16 Secure Energy and Coal Synthetics in these series of  
17 documents that I have in the binder and then added  
18 to that the computations we presented in my report  
19 and tables 1 and 2 and 3 plus described in terms of  
20 rates of return, discount rates that we used, so  
21 it's the computation that ultimately gave us these  
22 tables 1, 2, and 3 in my report.

23 Q: When you say you started by replicating  
24 the forecasts that Secure had used in the other  
25 documents, what do you mean by that, by replication?

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1 don't recall that we replicated the balance sheets.  
2 I normally would not have. And then some of the  
3 underlying detail, for example, maintenance and  
4 catalyst costs which are page 9 in the index, we  
5 wouldn't have replicated that. We would have  
6 replicated it at the income statement level.

7 Q: Okay. Let's go to -- you said page 4. I  
8 have that as SEI-5849. Do I have that correct?

9 A: Yes.

10 Q: Okay. And as I understand what you're  
11 saying, you replicated this entire spreadsheet in  
12 your Excel spreadsheet; is that right?

13 A: Yes.

14 Q: Okay. All of the data here was keyed in  
15 or did you get an electronic copy somewhere?

16 A: I'm sorry, say it again.

17 Q: Was all of the data on SEI-5849 keyed into  
18 your spreadsheet or did you get an electronic copy  
19 from somewhere?

20 A: No, what we received were these PDFs. You  
21 can't move from a PDF into an Excel, at least in the  
22 PDF we received, so these were rekeyed.

23 Q: Rekeyed by someone at your place?

24 A: Yes.

25 Q: And you said you did 5849 and I think you  
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1 said you did 5854? Did I have that right?

2 A: 5854, I don't --

3 Q: Isn't that the maintenance and operations?

4 A: Yes. I use that as an example of one we  
5 would not have.

6 Q: I'm sorry.

7 A: So 5854 -- so 5849, 5850 as an example of  
8 what we would have --

9 Q: Okay.

10 A: -- would have keyed in.

11 Q: How about 5852? Did you have any interest  
12 in that?

13 A: I'm sorry. I didn't quite understand the  
14 question. Did I have an interest in it?

15 Q: Did you have that keyed into your new  
16 spreadsheet?

17 A: Okay. I heard that question differently.

18 Q: Yeah, what I said was did you have an  
19 interest in it. What I meant was I assumed you were  
20 keying into your spreadsheet items that were of  
21 interest to you.

22 A: We were keying into our spreadsheet what  
23 would allow us to come to income numbers, so this  
24 may have had some interest to me and I did review  
25 every page of every document that we've got in all

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1 of these binders. But I don't believe that found  
2 its way on to this spreadsheet because it was just a  
3 subpart that drives to -- we weren't trying to  
4 replicate this entire model. We were trying to  
5 replicate in Excel so we could work with it, the  
6 income and cash flow numbers that were important to  
7 the valuation process that we were going through.

8 Q: That's what I meant when I asked you  
9 originally by what do you mean by "replicate." You  
10 were replicating those parts that would be used  
11 specifically in your model?

12 A: That's correct. Keying into our Excel  
13 spreadsheets so we could do math.

14 Q: Is it fair to say that most of the stuff,  
15 most of the numbers on 5849 were not necessary for  
16 your model? In other words, there are baseline  
17 numbers that you could have drawn out and just  
18 plugged into your model, right?

19 A: There's a number of different ways you  
20 could have gone about it. But we keyed in this data  
21 to give us the income statement information.

22 Q: Let's try it this way. Why don't you turn  
23 to page 7 of your report which is Exhibit 1. And  
24 just take the top left number, top left dollar  
25 number in table 1 there, "Earnings Before Taxes,"

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1 here -- 49 and 50.

2 Q: Okay. Did you check any of the  
3 assumptions about the data in the forecasts that  
4 ended up in 5849 and 5850?

5 A: We discussed these forecasts during our --  
6 during our meetings to gain an understanding of what  
7 was being forecasted. The -- some of the other  
8 documents that are presented here gave --  
9 additionally gave color and flavor and description  
10 of, you know, assumptions were embedded in the  
11 forecasts, so it was all part of the review process.

12 Q: What documents in your binder there gave  
13 color, flavor, and description to those two lines  
14 from 5849 or 5850?

15 A: Well, it gave color and forecast to --

16 Q: Color and flavor.

17 A: Did I say flavor?

18 Q: You said forecast.

19 A: To the whole of the -- to the whole of the  
20 set of assumptions that were underlying those --  
21 those forecast documents that we were looking at.

22 Q: Can you point to anything specific that  
23 said, yep, that's why this is right; this forecast  
24 is valid?

25 A: What I said was color and flavor. It was  
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1 a description of the business plan. There's an  
2 offering memorandum -- I'll call it an offering  
3 memorandum in here, the presentations, the Power  
4 Point presentations describing what Secure Energy  
5 was -- what their business plan was all about. I  
6 think we had referenced --

7 Q: Maybe we can -- if you can slow down we  
8 can identify the document you're talking about. You  
9 said an offering memorandum or did you have  
10 something else you said first?

11 A: What I'm going to do is go through my  
12 binder and just name the documents that we looked  
13 at. The DAI Management Consultant document that we  
14 talked about.

15 Q: Dated?

16 A: This is July 16th, '07.

17 Q: Let me stop you on that one just real  
18 quick. Did you check the data in the July 16th,  
19 2007 against any of the data in the May 23, 2008  
20 financial model?

21 A: It wasn't an exercise that lended itself  
22 to monotonic data checking.

23 Q: My answer -- the answer to my question is  
24 no, you did not?

25 A: Because it wasn't a process that was --  
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1 the costs?

2 A: Well, as I have told you, I reviewed every  
3 page in these binders in detail. I see that the  
4 financial forecasts that were here included  
5 assumptions. In terms of verification, again, it's  
6 a forecast. It isn't like an audit where we can go  
7 in and vouch payroll or vouch, you know, vendor  
8 payments. It seemed reasonable. It seemed very --  
9 it was very detailed, very thorough in its  
10 construction. There was a discussion about head  
11 count during construction period, during the  
12 operating period, and it seemed like a very  
13 detailed, well-thought-out, well-constructed  
14 forecast, and in my judgment it was reliable.

15 Q: Is this forecast typical of the kind of  
16 forecast you see for an enterprise involved in this  
17 kind of work?

18 A: This -- involved in this kind of work  
19 being putting together financial forecasts, this was  
20 a very thorough, very detailed financial forecast,  
21 and typically what I see is much less so, you know,  
22 summary level sales dollars, percent growth year to  
23 year, and some, you know, operating expenses in  
24 broad aggregates. No, this was a very, very  
25 thorough, detailed forecast, much better than

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1 95 percent of what else I see.

2 Q: And that's true of each of the forecasts  
3 you looked at for these folks?

4 A: Well, their -- their modeling clearly is  
5 the same model. I mean, you can follow the page and  
6 the structure and the format, so, you know, it  
7 certainly implied to me that there was a very  
8 thorough process that had gone on in terms of  
9 considering all of the various details of -- that  
10 comprised each of the line items. There are  
11 supporting pages for each of the categories, so they  
12 get an A in my class for this work.

13 Q: Okay. When you say each of the models,  
14 are you talking about each of the two models in  
15 May 2008 or the models in 2006, 2008, or 2009?

16 A: Well, there's a number of different  
17 models. The framework and the architecture of the  
18 models if you look at the pages, they appear to be  
19 the same.

20 Q: Okay. The inputs would be different?

21 A: Well, the inputs were different, yes.

22 Q: Do you know who RW Beck is?

23 A: It's not ringing a bell.

24 Q: Did anybody ever mention to you in your  
25 work in this case a criticism of the financial

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1           A: Well, we pushed the cash flow out three  
2 years in time before we applied the discounting, and  
3 we used a very heavy discounting rate, so that's  
4 going to convert a dollar to substantially less than  
5 that in the damage calculation.

6           Q: Is that why you pushed it out because of  
7 difficulty in obtaining financing?

8           A: No, more to account for the -- for the  
9 construction process that I understood may be about  
10 a two year, maybe a two year and change, two year  
11 and a couple months, and we just pushed it out three  
12 years to be conservative.

13          Q: But if they're not getting financing  
14 they're not getting construction under way, it's  
15 getting pushed out further, right?

16          A: Well, my mission here was to value the  
17 trade secrets of SEI and the value of the assets  
18 separate from specifically this project, is my view  
19 of that.

20          Q: The value of the assets separate from the  
21 project?

22          A: Well, the trade secret -- this is a value  
23 of an asset. The asset is the trade secrets of SEI  
24 and the fair market value of that, so in my view, it  
25 isn't specifically dependent upon, you know, a

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1 finite start date for construction to give an  
2 opinion as to what the value of these trade secrets  
3 are.

4 Q: Okay. And if they never obtain financing  
5 and there never is construction, that would not have  
6 an impact on your valuation?

7 A: That's not to say that the trade secrets  
8 themselves don't have value.

9 Q: But the inability to get financing for  
10 them for the application of the trade secret would  
11 have an impact on value, would it not?

12 A: Not on the -- not on the separate asset of  
13 the trade secrets. It's the value of the assets in  
14 the marketplace as opposed to the value of the  
15 assets in the hands of -- that's -- we're getting  
16 very esoteric here, but that's a fair market value  
17 concept.

18 Q: Well, wait a minute. You derived the  
19 value from a projection of the construction and  
20 operation of this particular plant, right, not from  
21 any plant in the marketplace. One plant, right? If  
22 that plant --

23 A: Which --

24 Q: No, go ahead. I don't mean to interrupt  
25 you. Is that right?

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1 was overstated on cost -- I'm sorry, understated on  
2 cost or overstated on revenue, it wouldn't make a  
3 difference to your valuation of the IP, right?

4 A: I'm going to come back to the same answer  
5 I've given a dozen times now. I've reviewed it; it  
6 seemed reasonable. It was very thorough, well  
7 constructed, well thought through, and a reasonable  
8 basis for valuing this -- these trade secrets.

9 Q: And you would say the same with the Coal  
10 Synthetics projection?

11 A: Coal Synthetics had the same models down  
12 to the same formatting on some of the pages. They  
13 were much more aggressive on the revenue side. And  
14 as I had indicated, if you put their forecast  
15 through the same processes, the value using Coal  
16 Synthetics' forecast for the -- it's almost  
17 \$76 million.

18 Q: And you would consider that to be a  
19 legitimate projection of the value of this  
20 intellectual property?

21 A: My opinion of value that I give in my  
22 report was 18 to 24 million which was based on the  
23 much more conservative forecasts of SEI and not the  
24 more aggressive forecasts of Coal Synthetics.

25 Q: So it's a difference between the

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1 MR. HALLINAN: I don't know, trade secret  
2 expense.

3 THE WITNESS: Well, if you look in the  
4 paragraph in the middle of that page citing out of  
5 the complaint, "Coal gasification is a fledgling  
6 industry in the United States, and SEI required more  
7 than \$43 million in expenditures to advance the  
8 Decatur project to the present state of  
9 development."

10 BY MR. HALLINAN:

11 Q: Uh-huh. Do you have any idea how much of  
12 that 40 million was advancing the trade secret  
13 information, developing the trade secret  
14 information?

15 A: I didn't attempt to parse that out.

16 Q: Okay. Does it make any difference to you?

17 A: No.

18 Q: In order to determine the reasonableness  
19 of your royalty calculation, it does not make a  
20 difference to you how much was actually spent on the  
21 trade secret information; is that correct?

22 A: I did look at it more globally in terms of  
23 internal rates of return that were presented and  
24 that were described in some of the documents. I  
25 didn't review rate of returns because I didn't parse

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1 out a dollar to a trade secret versus a dollar to a  
2 bucket of bolts and nuts.

3 Q: So the answer to my question is it didn't  
4 make a difference to you?

5 A: That wasn't part of my analysis, so that's  
6 correct.

7 Q: The cost of development of the trade  
8 secrets makes no difference in your reasonable  
9 royalty calculation, true?

10 A: We didn't undertake a cost --

11 Q: You can't answer that one yes or no; is  
12 that correct?

13 A: We didn't undertake a cost approach.

14 Q: Tell me first -- you can't or can answer  
15 it yes or no? Why is this causing you so much  
16 trouble?

17 A: I'm trying to recall how you asked -- what  
18 question you asked. I got lost.

19 MR. HALLINAN: Read the question back,  
20 please.

21 (Record read by the reporter.)

22 THE WITNESS: It didn't play into that,  
23 that's true.

24 BY MR. HALLINAN:

25 Q: In general terms based on your experience  
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1 in the industry, does the cost of the development of  
2 the trade secrets affect the reasonableness of the  
3 royalty?

4 A: Not necessarily but it could impact the  
5 value of the trade secret. We could have found  
6 value of the trade secret based on a cost approach  
7 as opposed to an income approach and it would have  
8 likely been more.

9 Q: Why do you say it likely would have been  
10 more?

11 A: If some portion of this 43 million was  
12 non-trade-secret related, and I didn't attempt to  
13 parse out how much of the 43 million, if that's the  
14 number we'll be using, was or wasn't.

15 Q: What if 42,500,000 was attributable to  
16 non-trade secret expenses?

17 A: Okay.

18 Q: That would make your reasonable royalty  
19 calculation a little bit overstated, right?

20 A: No, not at all.

21 Q: \$500,000 for the expenditure to acquire  
22 reasonable -- or to acquire trade secrets would  
23 result in \$18 million in value for your trade  
24 secrets?

25 A: Because that's the earnings that those

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1 MR. HALLINAN: State it and we'll move on.

2 MR. DEVEREUX: Thank you. There are so  
3 many pieces to that question, it would be impossible  
4 to answer it. You include five subject matter  
5 aspects to that question.

6 BY MR. HALLINAN:

7 Q: Are you familiar with restrictions on the  
8 period of time in which a damage analysis for a non  
9 or anticompetitive situations can be calculated?

10 A: That's very broad. I've got bookshelves  
11 full of books on treatises on valuation of  
12 intellectual property and intangible assets and we  
13 consulted those. I can't say that I have a treatise  
14 that I could point to that would answer yes to your  
15 question.

16 Q: As you sit here today you're not familiar  
17 with the concept of limiting the damage period by  
18 the amount of time it would take a participant to  
19 enter the market?

20 A: Not specifically.

21 Q: Okay. That's all I was asking. How long  
22 do you think it would take to enter the market?

23 A: I think five years is a reasonable  
24 estimate. But I think it's a reasonable approach to  
25 the value of these trade secrets.

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1 Q: You understand that SEI entered the market  
2 in three years; is that right?

3 A: No.

4 Q: You understand that SEI developed the  
5 volume of trade secrets that was stolen in three  
6 years or less, right?

7 A: Well, we've been looking at the dates of  
8 founding in 2005 and the October 2008 date when the  
9 discovery of the theft of the trade secrets  
10 occurred, and then you've got a two to three -- two,  
11 two-and-a-half-year construction period included as  
12 well, so that certainly gets you to five.

13 Q: Wait a minute. Your five-year period  
14 doesn't start running until after construction is  
15 completed, so your five-year period if you're going  
16 to include construction is eight years; isn't that  
17 true?

18 A: Maybe I should -- I mischaracterized the  
19 answer, but it's my opinion --

20 Q: You were mistaken? It wasn't five years;  
21 it's eight years if you're going to include the  
22 construction period? Having trouble with that  
23 question?

24 A: No, I'm not having trouble with that  
25 question, sir. It's my opinion that five years was

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1 a reasonable royalty period to determine the value  
2 of the trade secrets.

3 Q: Other than your ipse dixit that's the  
4 reasonable period, do you have anything you can  
5 point to that would say that that's a reasonable  
6 period? Any other measure, any other -- anything  
7 else you can point to?

8 A: Well, I didn't bring my library with me  
9 that gives us guidances as accountants on how to  
10 determine value of trade secrets, so we didn't  
11 consult with a -- our library, so -- it was  
12 reasonable to me based on the research that we were  
13 doing on how to go about determining the damages or  
14 value in this case.

15 Q: Why don't you put your library references  
16 for the five- or eight-year period in your report?  
17 You put it for other things that you got out of the  
18 library.

19 A: Didn't occur to me.

20 Q: As we sit here today, we have nothing but  
21 your word, your ipse dixit that it's five to eight  
22 years, right?

23 MR. DEVEREUX: It mischaracterizes the  
24 evidence. He said it was five years.

25 THE WITNESS: I --  
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1 MR. HALLINAN: Or eight if you include the  
2 construction.

3 THE WITNESS: I used a five-year period of  
4 royalty to quantify the value of the intellectual  
5 property in this case.

6 BY MR. HALLINAN:

7 Q: That's not the period to enter the market;  
8 that would also include the construction period too  
9 which would be eight years, right?

10 A: So what are you doing, adding five years  
11 of forecast and two years of construction?

12 Q: Uh-huh.

13 A: That's seven.

14 Q: Seven, okay.

15 A: I'm not sure what that means though.

16 Q: Neither am I.

17 A: You're confusing me.

18 Q: What's the five -- how did you determine  
19 the five-year royalty period? You got a library  
20 book, right?

21 A: First and foremost it was -- as I said, we  
22 looked at it against a five-, a ten-, and a  
23 fifteen-year period. I had to make some judgments  
24 about what I thought was reasonable. We consulted a  
25 number of the books that we had in our library about

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1 what was reasonable in terms of damages for theft or  
2 trade secrets, and I came down on the judgment that  
3 it -- we'd use a five-year period rather than a ten  
4 or fifteen.

5 Q: You also reference the state of  
6 development of the coal gasification industry in the  
7 United States as a reason for using the five-year  
8 period. Do you see where I'm at on page 6?

9 A: I do see that.

10 Q: What is the state of development -- the  
11 current state of development of the coal  
12 gasification industry in the United States?

13 A: It's my understanding that for the  
14 particular part that was purchased from Siemens  
15 there's only been about five or six or seven of  
16 those sold worldwide that would be part of the plant  
17 design. The -- just part of the background  
18 information that we looked at or that I  
19 characterized at the very beginning of the day  
20 looking at web site research, and we had an SEC  
21 filing of a company that was in the industry doing,  
22 you know, subtly different things with their plant  
23 designs and so on. Statement about the background.

24 Q: Okay. So you're saying that there are  
25 five to seven gasifiers purchased from Siemens; is

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1 observed in the venture capital markets." Have I  
2 read that correctly?

3 A: That's what it says.

4 Q: Where would I go to -- where would I go to  
5 observe typical venture capital market rates of  
6 return?

7 A: I've got some studies on that.

8 Q: The studies typical -- strike that.

9 Do venture capital market rates vary?

10 A: They certainly can.

11 Q: How do you define "typical" when you have  
12 varying rates in the market?

13 A: Studies I've read is that VC rates were  
14 centering around 35 percent. You know, I'm very  
15 comfortable with a 35 percent rate because it is so  
16 high. You know, you've got a risk premium -- if you  
17 decompose the number, you've got a risk premium of  
18 24 percent which is an extremely high risk premium  
19 by any measure of pure CAPM with a Beta of 4 or  
20 however you wanted to get to it so...

21 Q: Are you aware that financing for this  
22 project was difficult to obtain prior to 2008?

23 A: I've seen the documents with multiple  
24 requests for financing.

25 Q: Are you aware that two private equity

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